The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, NOVEMBER 9, 1981 VOLUME XVIII, NUMBER 45

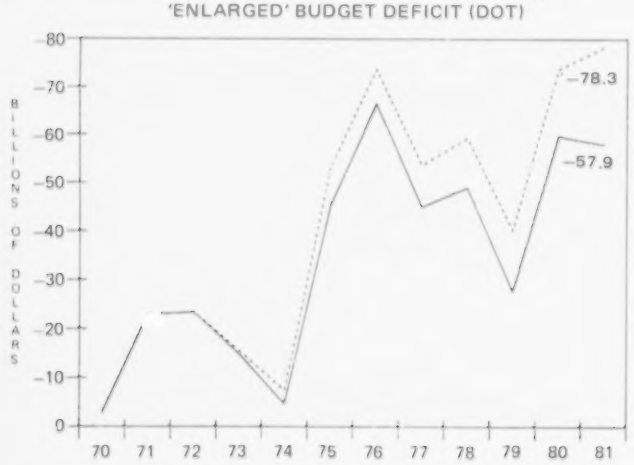
B 5310-2

Washington Sets A Record

One of the more persistent fears overhanging the credit markets is that expanding Federal government borrowing requirements will increasingly displace private sector credit needs. Recent financial developments have done little to relieve these concerns—despite a slight dip in the size of the reported budget deficit in fiscal year 1981. Buoyed by a $6.9 billion surplus in September, the fiscal 1981 red ink total narrowed to $57.9 billion, slightly below the $59.6 billion deficit posted in fiscal 1980.

Once again, spending increases were dominated by stepped-up income security outlays as well as interest payments, despite the added emphasis being placed on national defense. Together, these outlays accounted for two of every three additional on-budget dollars spent in fiscal 1981, while increased defense spending accounted for about 29 per cent of the $81 billion expenditure gain. Clearly, any substantial increase in defense spending above current levels in the absence of either new revenue sources or scaled-back nondefense spending and interest outlays, will dash any residual hopes that the Federal budget can be balanced by fiscal 1984.

'REPORTED' BUDGET DEFICIT (LINE) VS. 'ENLARGED' BUDGET DEFICIT (DOT)



What is more, the regular budget deficit provides an increasingly distorted picture of trends in Federal finance. In fiscal 1981, "off-budget" outlays, primarily those of the Federal Financing Bank (FFB), soared to more than $20 billion—$6 billion higher than in fiscal 1980. Created at the end of 1973 and commencing operations in 1974, the FFB (which possesses unlimited borrowing authority at the Treasury) is authorized to purchase the loan assets of such on-budget agencies as the Export-Import Bank and Farmers Home Administration.

But in so doing, the FFB not only provides additional resources to the affected agencies but actually converts on-budget loans into off-budget outlays. Since there is no substantial difference in the impact of on- and off-budget Federal spending (or associated borrowing requirements), these activities should be included with the on-budget totals when measuring the size and effects of the Federal deficit. Doing so results in an "enlarged" Federal deficit of $78.3 billion in fiscal 1981, $4.5 billion above the fiscal 1980 level—transforming what had been a modest narrowing of the regular budget deficit into a new record high.

Corporate Profits Are Depressed . . .

Another piece of bad economic news involves the third-quarter earnings picture. According to preliminary estimates by this Bank, corporate profits (adjusted for inventory gains) posted their second quarterly drop in a row, falling 1-1/4 per cent, quarter-to-quarter. Although corporate earnings were about 3.5 per cent above their depressed year-earlier levels, they were still six per cent below the peak reached in the first quarter of 1980. What is more, there are many signs pointing to another fall in the current quarter.

Last quarter's earnings were depressed once again by lackluster final sales, rising labor and financing costs, the strong external value of the dollar as well as a large drop in productivity—the first this year. But the decline in corporate earnings was not nearly as steep as that posted during the previous quarter when they fell by six per cent. One reason is that during the three months ending in September, many producers were able to raise the prices of their products while the cost of raw materials used for production declined. The producer price index shows that during the July-September period

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finished goods' prices rose at an annual rate of 3.7 per cent while the cost of crude materials declined by nearly five per cent. This is in sharp contrast to the previous three-month period, when the rise in raw materials' prices outpaced the increase in the price of finished products.

. . . By The Rising Dollar And Labor Costs

However, partially offsetting this favorable spread was the sharp rise in unit labor costs which reflect changes in hourly compensation and productivity. Since hourly compensation advanced at an annual rate of 9.3 per cent in the third quarter compared with the second and productivity declined, unit labor costs jumped by 11.4 per cent. This was virtually double the increase registered during the preceding quarter. What is more, high labor costs may continue to impact earnings for some time. Major collective bargaining settlements reached in private industry during the three months ending in September, provided wage adjustments averaging 12.1 per cent (not including cost-of-living clauses)—up sharply from an advance of 10.6 per cent received during the first six months of the year. The average life of the negotiated contract was almost three years.

Another important deterrent to profitability last quarter was the rising external value of the dollar vis-à-vis other major currencies. One of the more

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/28/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	132.103	– 2.197	+ 1.561
Loans to Depository Inst.	1.187	– .068	– .248
Float	2.995	– .512	– .319
Total Reserve Bank Credit	145.643	– 2.957	+ 3.888
Treasury Deposits with Federal Reserve Banks	3.069	– .674	– .121
Currency Outside Banks	123.384	– 1.423	+ 4.469
Member Bank Reserves:			
Required	40.625	– .620	– 1.305
Excess (Deficiency)	.223	+ .090	+ .187
Total Reserves Held	40.848	– .530	– 1.118
Net Borrowed Reserves	.817	– .150	– .495
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	90.482	– .008	+ 4.805

		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1-B	431.1	+ 3.1‡	+ 4.1‡
M2 (September '81)	1,786.6	+ 8.5	+ 8.6
M3 (September '81)	2,131.8	+ 10.2	+ 11.4
L (July '81)	2,521.3	+ 10.4	+ 11.3

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 11/6/81			
‡ U.S. Treasury Bills	11.90%	12.35%	12.10%
* Federal Agencies	12.55	13.65	13.90
* Project Notes—Taxfree (46% Taxable Equivalent)	12.50	13.89	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	13.75	13.88	14.50

‡ Finance Company Paper—Prime

5- 14 days	13.50%
15- 29 days	13.50
30- 59 days	13.50
60- 89 days	13.50
90-179 days	13.25
180-239 days	12.50
240-270 days	12.00

‡* Bankers' Acceptances

Dec.	13.65%
Jan.	13.45
Feb.	13.35
Mar.	13.35
Apr.	13.35
May	13.10

‡ Industrial Paper—Prime

30- 89 days	13.60%
90-120 days	13.50

† Federal Funds Effective Rate 13.80%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'81	$ 2,947	$ 2,886	$ 2,637
Gross National Product (1972 Dollars)*	3rd Q'81	$ 1,508	$ 1,510	$ 1,472
Percent Change, Annual Rate	3rd Q'81	– 0.6%	– 1.6%	2.4%
Change in Consumer Prices (all urban consumers)*	Sept '81	14.4%	9.6%	12.0%
Change in Producer Prices*	Sept '81	2.4%	3.6%	3.6%
Civilian Employment (Thousands of Persons) †	Oct '81n	98,217	98,270	97,206
Unemployment as % of Civilian Labor Force †	Oct '81n	8.0%	7.5%	7.6%
Personal Income*	Sept '81	$ 2,461	$ 2,441	$ 2,206
Leading Indicators Composite Index (1967=100) †	Sept '81	130.1	133.7	134.4
Industrial Production Index (1967=100) †	Sept '81	152.1	153.3	144.4
Net Change in Consumer Installment Credit †	Sept '81n	$ 2.82	$ 2.86	$ 1.06
U.S. Merchandise Trade Balance †	Sept '81	–$ 1.57	–$ 4.48	–$ 1.11
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Sept '81	918	934	1,482
New Construction Expenditures*	Sept '81n	$ 231.6	$ 232.6	$ 224.6
Total Business Inventories†	Aug '81	$ 501.7	$ 498.1	$ 468.9
Total Business Sales †	Aug '81	$ 350.8	$ 354.5	$ 317.9

* Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. a-Anticipated.

significant major effects was on the profitability of foreign operations of domestic companies. As the dollar appreciated, companies with extensive foreign operations, such as those in the petroleum and pharmaceutical industries, suffered sizable currency translation losses, when converting their overseas earnings streams (expressed in local currencies) into dollars.

The worst results were recorded once again by automobile manufacturers. Reflecting the slump in new car sales, high interest rates, retooling costs for 1982 models and such costly promotional campaigns as rebates and interest subsidies, the Big Three reported a combined after-tax loss of almost $1 billion during the third quarter. So far during the fourth quarter, new-car sales fell even further—reaching a 23-year low in October—despite the continuation of costly promotions, portending another poor quarter for the auto companies.

Despite the slide in auto sales and auto production, the steel industry fared better than expected. While some portion of earnings was due to such nonrecurring gains as sales of plant and equipment, steelmakers' profits were boosted by sales of pipes and tubes used for gas and oil exploration. In addition, their earnings were improved by cutting expenses, as many workers were laid off, plants were closed, inefficient operations phased out and inventories brought more in balance with demand.

(Continued on back page)

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (10/21/81)	129,626	– 1,691	+32,940
New York City (10/21/81)	32,042	– 366	+ 9,522
Commercial Paper (10/21/81)	163,729	+ 1,050	+40,642

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

	Latest Week	Change Since Week Ago	Change Since Year Ago
Weekly Reporting Large Commercial Banks			
Nationwide (10/21/81)	188,333	– 6	+21,996
New York City (10/21/81)	55,055	+ 112	+ 6,650

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/21/81)	460,191	+ 888	+48,819
New York City (10/21/81)	112,430	+ 1,813	+17,799

Financial Markets

		Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	12.63%	– .62	– .39
180-Day Bills†	13.12	– .73	+ .28
Longest Bills†	13.50	– .85	+ 1.33
Recent Issues:			
15 1/2s 10/31/83	13.83	– .47	
15 7/8s 9/30/85	13.97	– .68	
14 1/4s 11/15/91 (When Issued)	13.90	NA	
14s 11/15/11 (When Issued)	13.82	NA	
Municipals:			
Bond Buyer–20 Bond Index* (11/5/81)	12.44%	– .55	+ 2.80
Blue List Total ($ Million)	$ 747	– $113	– $ 61
30-Day Visible Supply ($ Million)	$1,875	+ $154	– $ 515
Total	$2,622	+ $ 80	– $ 576
Corporates:			
Moody's Aa Composite (11/5/81)	15.41%	– .54	+ 2.07
30-Day Visible Supply ($ Million)	$6,636	– $809	+ $2,553
Stocks:			
Dow-Jones Averages:			
Industrials	852.45	– .10	– 79.97
Transportation	383.17	+ 7.57	+ 19.95
Utilities	107.53	+ .68	– 2.41
65 Stocks	343.18	+ 2.55	– 10.63
Standard and Poor's 500 Stocks	122.67	+ .78	– 6.51
N.Y.S.E. Composite Index	71.33	+ .69	– 3.02
N.Y.S.E. Avg. Daily Vol. for Week (000's)	53,498	+ 5,652	+ 1,243

* 46% Taxable equivalent 23.04%.

† Bond equivalent.

International Rates

	Friday 11/6/81	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	14.00%	14.25%
1 month	14.50	15.06
3 month	14.69	15.75
6 month	15.00	16.06
1 year	15.13	16.13
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	15.25%	15.75%
Long Term (7 to 15 yrs.)	15.35	15.75

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/6/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02672	37.43
Canada	.8368	1.1951
Denmark	.1400	7.1453
France	.1783	5.6100
Germany	.4498	2.2233
Italy	.0008435	1185.50
Japan	.004369	228.90
Mexico	.03906	25.60
Netherlands	.4091	2.4445
Switzerland	.5576	1.7935
U.K.	1.8733	.5338

In contrast, producers of nonferrous metals in general and copper in particular were hit hard by the slump in housing, automobiles and machinery markets. For example, during July and August (latest available data), consumption of copper slipped by four per cent, and stocks held by both producers and consumers swelled.

U.S. Trade Begins To Weaken

In spite of continuing dire predictions of a plunging U.S. trade deficit due to the strength of the dollar, the preliminary trade figures for September show no irrefutable evidence of this trend. As was pointed out last month (Financial Digest—October 9, 1981), U.S. trade has been remarkably stable so far this year. The large $5.6 billion trade deficit (seasonally adjusted; exports, f.a.s./imports, c.i.f.) in August, which was widely heralded as conclusive evidence of a decline in exports and a surge of imports, gave way in September to a much smaller trade deficit of $2.6 billion. Exports, in fact, rose by 3.2 per cent in September over the previous month and imports fell by 9.9 per cent.

Taking a longer view, the preliminary data on the merchandise trade deficit for the third quarter of 1981 on the balance of payments basis indicate some deterioration in the U.S. trade position. For the quarter as a whole, imports declined three per cent while exports declined four per cent compared with the previous quarter. While the accumulated trade deficit for the first three quarters of this year appears to be slightly lower than for the same period last year, the data nonetheless suggest a gradual and intermittant erosion of the U.S. trade position.

Last month's decline in imports can be explained by the growing weakness of the U.S. economy, and to some extent this may account for the continued strength in exports. As domestic demand declines, delivery times for export orders shorten. This tends to push exports forward, which implies that deliveries anticipated for future months may have been recorded in September. If this proves to be the case, then exports over the next several months could weaken, adding to the trade deficit. The U.S. trade position will, however, receive some near-term benefits if the dollar weakens in response to the decline in U.S. interest rates. This would make exports more competitive and imports more expensive.

A surplus on U.S. trade with Western Europe is an important feature of the U.S. trade balance and helps compensate for deficits in other areas. Last month, the U.S. trade surplus with Western Europe was $1.5 billion after a small $115 million surplus in August. In the first eight months of this year, the U.S. surplus with Western Europe was running at a seasonally adjusted annual rate of $14 billion, compared with almost $21 billion last year.

The U.S. trade deficit with Japan remains large. In the past two months, the United States ran a trade deficit of $3.6 billion with Japan. This was 44 per cent of the total U.S. trade deficit for that period. This year's total deficit on trade with Japan is expected to be close to $15 billion after a $10 billion deficit in 1980. Japan also expects to show a $10 billion surplus this year in its trade with Western Europe. Overall, Japan anticipates a trade surplus of some $6.5 billion this year, which will contribute to an expected current account surplus of close to $10 billion for this country, after a deficit of $11 billion in 1980. M

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